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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

AUSTIN F. MCFEE, *Petitioner,*

v.

UNITED STATES OF AMERICA, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, which, upon remand by this Court for futher consideration, affirmed his conviction for violation of section 145(b) of Title 26, United States Code.

OPINIONS BELOW

The per curiam opinion of the Court of Appeals is not ~~yet reported. It is set forth in the appendix hereto p.~~ .
yet reported. It is set forth in the appendix hereto p. 1.
24, 1953, is set forth at page 444 of the printed record

prior opinion of the Court of Appeals, entered July

filed with this Court in No. 15, October Term, 1954, and is reported at 206 F. (2d) 872.

JURISDICTION

The judgment of the Court of Appeals was dated and entered April 29, 1955. The jurisdiction of this Court is invoked under sections 1254(1) and 2101(d) of Title 28, United States Code and Rule 37(c) of the Rules of Criminal Procedure for the United States District Courts, and Rule 22(2) Rules of the Supreme Court of the United States.

QUESTIONS PRESENTED FOR REVIEW

1. Did the Government establish petitioner's business as a "likely source" of unreported income where the business operations in question were carried on entirely by employees in five different locations in four widely separated cities, and where all collections of money from such business were made and deposited in bank by employees and duly recorded by them in the books of account, and such books were carefully reconciled by other employees and thereafter by an expert accountant who included such amounts in petitioner's income tax returns, and where there was no evidence showing or tending to show that petitioner received, or had the opportunity to receive, or had any other means of access to any of the proceeds or assets of such business prior to due recordation thereof on the books of account?

(a) Where there was no evidence from which a jury could reasonably find that petitioner's alleged net worth increase came from a source capable of producing unreported taxable income, can it be assumed that such net worth increase was attributable to taxable income?

(b) Where the suspected source of petitioner's alleged unreported increase in net worth was a business carried on entirely by employees, and where the petitioner could not have obtained unrecorded income from such source

without collusion with one or more employees, and where there is no evidence from which a jury could reasonably find that there was any such collusion and where the evidence affirmatively shows that there was none, can it be said that the Government established such business as being a "likely source" of unreported income?

2. Did the Government establish, with reasonable certainty, an opening net worth?

(a) Was the Government's investigation of petitioner's prior financial history adequate where it made no investigation whatever of the period prior to 1935, nor of the period 1936-1941, inclusive, except to determine his reported net taxable income for such period, without allowance for or investigation of gross income or non-taxable income such as capital gains, depreciation, or collection of prior accounts receivable during such period, or of other capital assets on hand during said period?

(b) Was the Government's failure to include as an asset any portion of an item of $114,000 known to exist in 1943 erroneous?

3. Was the Government's investigation inadequate in that it failed to track down a "lead" with respect to the $114,000 item which, if investigated and included in petitioner's opening net worth, would have accounted for more than petitioner's entire alleged net worth increase for the first year of the indictment period?

4. Where the inclusion or non-inclusion of the proceeds of the $114,000 item was a vital element in the establishment of an opening net worth, and where such proceeds were not included because the investigating agents said that petitioner had told them the $114,000 item represented the sum total of a "turnover", was it necessary to require the Government to introduce substantial independent evidence which would tend to establish the trustworthiness of the alleged statement?

5. Where the Government did not establish a likely source of unreported taxable income, was in incumbent upon the accused not only to establish that the suspected source was not a likely source, but also to demonstrate to a mathematical certainty, by the production of temporary records, that his witnesses on this issue had told the truth?

(a) Was it error for the trial court to tell the jury that they were entitled to draw an adverse inference from the failure of the accused to thus verify the truth of the testimony of his witnesses who had stated that all income from the suspected source had been truthfully recorded?

6. Was the charge of the trial court on the subject of presumptive intent prejudicially erroneous?

STATUTE RELIED ON

The statute under which petitioner was prosecuted reads as follows:

Section 145(b), Title 26, United States Code:

> "Any person * * * who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution."

STATEMENT

Petitioner was convicted in the United States District Court for the District of Idaho, upon an indictment under section 145(b) of the Internal Revenue Code (1939), 26 USC 145(b), charging that petitioner willfully and knowingly attempted to defeat and evade income taxes for the years 1945 and 1946. On appeal the United States Court of Appeals for the Ninth Circuit affirmed 206 F. (2d) 872. Petition for certiorari was granted and the case

remanded for consideration in the light of *Holland* v. *United States,* 75 S. Ct. 127, and three other related cases (75 S. Ct. 311). The United States Court of Appeals again affirmed, per curiam (p. 1, Appendix post).

The Government's case was premised upon the theory that petitioner's net worth increased during the prosecution period years (1945 and 1946) in amounts of $79,911.23 and $69,769.76, respectively, in excess of his reported taxable income, and that such increases were attributable to taxable income.

The "Likely Source"

Petitioner lived at Wallace, Idaho. The suspected source of the alleged unreported income was petitioner's coin machine business operated under the name of North Idaho Sales Company. The main office of the Company was located at Wallace, Idaho, with branch offices at Coeur d'Alene, some 51 miles west, and at Lewiston, Idaho, some 175 miles southwest of Wallace. The coin machines, consisting of phonograph machines, vending machines, pinball machines, and slot machines, were placed in various locations in or centered around these three cities.

Collections were made entirely by employees, each of whom testified. A summary of the testimony with record references is set forth in the appendix hereto p. 1 post. Petitioner himself never made any collections. Each collector had a specific collection route. He alone had the keys to the various coin boxes along his route. There were no master or duplicate keys. If a key was lost the lock had to be drilled. Petitioner did not have a key. Each collector was provided with a collection book. Each book was serially numbered and charged to the collector. The pages of each book were numbered in triplicate sets. The collector would visit each location unlock the coin box of each machine, take out the cash, count it in the presence of the location owner, record it in the collection books in triplicate and turn over one-half to the location owner, as the latter's share. The location owner would sign the

collection page sheet as a receipt and would receive a carbon copy. All collections were turned in to the cashier or bookkeeper of the nearest company office who would verify the cash against the collection books, record the figures on a daily report record, deposit the cash in bank, and transmit the duplicate deposit slips and the daily report and the collection book to the main office at Wallace. There the collection book was again checked by the bookkeeper at Wallace, balanced against the bank deposits and entered in the Company's permanent books of account.

The books of account were turned over monthly to an independent expert (R. 62) accountant at Wallace who verified their accuracy and entered them in a general ledger which he kept.

During the first six months of the year 1945, petitioner also operated three taverns, one at Athol, Idaho, one at Coeur d'Alene, known as the Foresters Club and one at Lewiston, Idaho, also known as the Foresters Club. The tavern at Athol was sold in the summer of 1945 and the one at Coeur d'Alene was sold a month or two later. The one at Lewiston was operated throughout the prosecution period years. These taverns likewise were operated solely by employees, one of whom was the manager. All sales were rung up on the cash register, the cash was balanced daily against the register tape and recorded on a daily report sheet with the cash register tape attached, and the cash was banked by employees. The daily report and duplicate deposit slips were sent to the main office at Wallace, checked and balanced by the bookkeeper, and entered in the permanent books of account, and at monthly intervals were verified by the expert accountant at Wallace and entered in the general ledger kept by him. The expert accountant, called as a witness for the Government, testified that he prepared petitioner's tax returns, that such returns correctly reflected the income shown by the books of of account (R. 69, 76), and that petitioner could not have withdrawn money from the Company without due recordation thereof on the books of account (R. 76, 71).

A summary of the testimony of the tavern managers and the bookkeepers is set forth, with record references, in the appendix p. 4 post.

There is no evidence in the case in conflict with the foregoing facts. The Government agent testified that he had no knowledge as to the source of the alleged unreported income (R. 242). He merely assumed that it was income because he did not know where it came from (R. 250-254).

Opening Net Worth:

In making their investigation for the purpose of setting up an opening net worth, the Government Agents' examination extended back to the year 1942 (R. 280). During the course of their investigation Agent Rice said they came across an item which he referred to as an "item at issue related to 1943". "* * * it was somewhere around $114,000 * * *" (R. 263).

In 1943, due to war restrictions, alcoholic beverages were in short supply. In order to supply his own taverns and various other tavern owners where his coin machines were located, petitioner and one R. E. McDonnell (or McDonald —cf. R. 113 and R. 307) purchased approximately $114,000 worth of liquor from Herman Pastor in St. Paul, Minnesota in 1943 (R. 163, 307, 324). The transaction was handled through McDonnell who had a state liquor warehouse stamp or license (R. 307). The original payment to Pastor made in July 1943 was about $70,000 (R. 313). Additional payments of $23,340 and $26,600 were paid to Pastor. Of this total petitioner advanced $109,940. All payments were in cash (R. 288). The first shipment of 475 cases was received by petitioner on August 6, 1943 (R. 311) and according to the Government, petitioner was reimbursed therefor by the North Idaho Sales Company check for $25,300 issued on that date (R. 318). This was not taken into account as an asset (R. 287).

After four shipments had been received, petitioner paid for and received seven additional shipments the last deliv-

ery being about December 29, 1944. The account was closed out October 6, 1945.

From time to time as needed the liquor was turned over at cost plus expenses to various tavern owners, but chiefly to petitioner's Foresters Clubs at Lewiston and Coeur d'Alene, and petitioner was reimbursed from time to time from these sources for his original cash outlay. The retail sales were reflected in the gross sales of petitioner's taverns and duly included in gross income. Petitioner made no further investment in this operation other than his original $109,940. By the end of 1944 he had received in cash $62,338.81, $2,500 of which was banked. In 1945 he received $14,323.65 additional cash, he paid $7,400 to the bank on his note and he paid $3,000 to Sonduck all from this source. His net cash receipts from this source was $87,062.46.

The entire transaction showing investment, the source and disposition of each case of liquor from each shipment and each payment to petitioner is shown in the 73 page account, a photostat of which is on file with the Clerk of this Court.

The Government Agents discussed this item with petitioner (R. 288) who said he believed all profits were reflected on the Foresters Clubs books of account. They were. But petitioner's acquisition of the liquor from Pastor was handled as a personal transaction and was not reflected on the Company books. He used his separate cash therefor, and was subsequently reimbursed after the liquor was delivered.

When the Government Agent made up petitioner's opening net worth statement for January 1, 1945, he omitted all assets derived from this $114,000 item which existed in 1943, because he said they did not show up on the books of the North Idaho Sales Company. The Government Agent said he "followed the books" and he gave no credit for this item in his opening net worth computation (R. 288). The purchases of liquor from petitioner by the Foresters

Clubs was shown on the books of account of those two clubs, but those books, kept by Emasio, were entirely separate from the North Idaho Sales Company books (R. 75).

The agent sought to justify his position by stating (1) that they had evidence of from 5 to 7 loads coming from the east and (2) that petitioner had told them it was a "turnover" (R. 288). Being a "turnover" he included none of it.

The cash available to petitioner on January 1, 1945, from this source alone was $86,528.59.* This was more than enough to completely exonerate petitioner for the year 1945, and leave a balance of $6,617.36.

$71,172.64 thereof was received by petitioner from the Foresters clubs during 1943, 1944 and 1945. These payments for inventory were reflected on the books of account of those clubs. These books of account were in the possession of Emasio (R. 75) who was a Government witness. There is no evidence that the agents examined these books to trace down this item of $114,000. Lucile Dolan, manager of the Coeur d'Alene office of the Company during the period of investigation was familiar with these purchases of inventory from petitioner (R. 364, 367-368). She checked out the inventory and verified the payments to petitioner. There is no evidence that she was interviewed by the agents concerning this transaction. R. E. McDonnell was the man who actually handled the entire $114,000 transaction in 1943 (R. 307). The Government agents knew McDonnell was involved in the transaction, because the Government called him as a witness to testify concerning OPA fines growing out of it. Yet the Government produced no evidence showing that it had interviewed McDonnell concerning it. There is no evidence showing that this item was adequately investigated. If it was investigated, the information, favorable to the petitioner, was discarded or suppressed.

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* See affidavit of John N. Newland to which the photostat of the account of the "$114,000 item" is attached.

Further Errors:

In addition to the failure of the Government to include the $86,528.59 available from the $114,000 item, the Government Agents made the following errors in their net worth computation.

1. They failed to take into account as an asset, the $25,300 which was paid to petitioner on August 6, 1943, by North Idaho Sales Company in reimbursement to him of his cost for the first shipment of liquor (R. 318).	$25,300
2. They included as income $10,000 in cash paid to J. A. Allen to purchase stock (R. 140-142, 244). This payment was not income. It was made with money borrowed from John H. Mahoney (See Appendix p. 7, post)	$10,000
3. They included as income a cashiers check of $3,000 payable to Walter T. Murphy (R. 91-92, 116, 244, Ex. 18). Murphy was attorney for Iva Ensign who sold a tavern to O. M. Gunderson. Gunderson borrowed the money from North Idaho Sales Company who bought the cashiers check with its own check to the bank. See Appendix p. 8 post for photostat of checks.	$ 3,000
4. The Government Agents failed to include as assets $32,484.33 representing a savings account in petitioner's name and an account receivable (see affidavit of John N. Newland, *supra*)	$32,484.33

These errors, together with the $6,617.36 excess from 1945, total $77,401.69 which is more than enough to exonerate petitioner for the year 1946.

REASONS FOR ALLOWANCE OF THE WRIT

1. The Government Did Not Establish a Likely Source of Unreported Currently Taxable Income

The decision of the Court of Appeals is in conflict with the decision of this Court in *Holland* v. *United States*, 348 U. S. 121, 75 S. Ct. 127, 136, — L. Ed. —, in that there is no evidence in this case from which a jury or a court could reasonably infer that the alleged net worth increase came from a probable or likely source capable of producing current income.

In *Holland* v. *United States, supra*, 75 S. Ct. at p. 136, this Court said:

> "• • • Increases in net worth, standing alone, cannot be assumed to be attributable to currently taxable income. But proof of a likely source, from which the jury could reasonably find that the net worth increases sprang, is sufficient."

Government Agent Olsen said they included the unexplained net worth increase as taxable income but that they did not know where it came from (R. 242, 244, 250-251). They merely assumed that it was current income.

The suspected source of the alleged net worth increase was petitioner's coin machine business. The Government's case was premised upon that theory. But there is no evidence from which a jury or court could reasonably find that petitioner received or had the opportunity to receive as much as one penny of unreported income from such source, or from any other source, during the prosecution period.

The testimony of the Government Agents Olsen and Rice contains not one word tending to show any source. The only Government witness remotely touching on the point was Masterson (R. 203, et seq.). He was a collector working for petitioner out of Wallace. His testimony is summarized in the Appendix, p. 2 post. There is nothing in his testimony showing or tending to show that peti-

tioner received or had access to or had the opportunity to receive, any amount of unrecorded collections. The testimony of petitioner's witnesses Bergland (R. 295), Sherman (R. 334), Fields (R. 347), Parsons (R. 355), Whitaker (R. 300), Dellyea (R. 325), Dolan (R. 360) and Poska (R. 399), summarized at p. 2 et seq. in the Appendix, shows that petitioner himself never made any collections (R. 348). He did not have a key to the machines (R. 299, 357). There was no master key (R. 299). No collections were ever turned over to him (R. 298, 350, 357). They were all collected, deposited in bank, verified and entered in the permanent books of account by employees, and included in petitioner's returns.

Petitioner's operations were carried on in 5 different locations in three widely separated cities. Petitioner is an older person, having been in business some 15 or 20 years prior to 1935 (R. 281). It is reasonable that his business would be carried on by employees.

According to the testimony of the various Government witnesses petitioner spent $54,000 between January 26 and June 27, 1945, almost entirely in currency. He loaned $37,500 to Sonduck between those dates (R. 169-170), $5,000 to Arnold (R. 144) and paid $11,500 to the Dan Mac Lease partnership (R. 161-162); and between June 27th and December 31, 1945, he spent $25,000 more in currency. For 1946 he is alleged to have spent $74,000 more, all of which was included as unreported income.

It would have been utterly impossible for a taxpayer whose business operations were carried on solely by employees, and whose books of account were kept solely by employees, and whose collections and banking was handled solely by employees to withhold or obtain such sizeable amounts continuously and repeatedly throughout a two year period without someone somewhere learning about it and without leaving a single trace of evidence concerning it.

In this case, as was held in *United States* v. *Lawrence L. Rice* (E. D. Va., January 14, 1955), — F. Supp. —,

55-1 USTC 9274, where the accused could not have obtained unrecorded income without the knowledge and connivance of employees, and where there was no suggestion of any such knowledge or connivance, there was a failure to show a likely or probable source of unreported income.

This Court has indicated that in net worth cases, the trial court and appellate courts should be alert to the reasonable inferences available both for and against the accused. *Holland* v. *United States, supra,* 75 S. Ct. at page 132. Up to the present time no court has been alert to the inferences "for" this accused.

There was substantial direct evidence of the existence of cash on hand (R. 394-395, 332, 304, 307). Yet the Government Agents completely omitted cash on hand as an opening net worth asset (App. p. 10 post).

Is it not more reasonable to infer that petitioner had substantial cash assets on hand at the beginning of 1945 than it is to conjecture that in some unknown and mysterious manner petitioner was able to obtain $150,000 in nickels and dimes and quarters out of coin machines and to convert it into currency without any employee or anyone else knowing about it? Had there been any such practice, the Government Agents surely would have discovered some trace of it.

Or if it must be assumed that petitioner had the ability to obtain unrecorded income surreptitiously, did he not have the same ability in 1942, 1943 and 1944 when the same business was operated in the same manner? The business prospered during those years.

The petitioner was convicted on mere suspicion. There was no evidence of any action taken by him or course of conduct during the prosecution period inconsistent with his complete innocence of the offense charged.

The Government could not and did not show a likely source of currently taxable unreported income because there was no such source. The actual source, subsequently discussed herein, was primarily from the proceeds of the "$114,000 item" which existed in 1943.

The Government's failure to show a "likely source" had the practical effect of shifting the burden of proof to the petitioner, for when the trial court denied his motion for judgment of acquittal, it became necessary for him to establish that the suspected source was not a likely source.

This, we submit, was contrary to this Court's pronouncement in *Holland* v. *United States, supra,* 75 S. Ct. at p. 137, to the effect that the Government has the burden of proof to establish beyond a reasonable doubt each element of the offense charged.

Petitioner assumed the burden and affirmatively established by his witnesses referred to above (see also appendix p. 1 post) the utter impossibility of the suspected source being the actual source of the alleged net worth increase.

But the trial court made the burden doubly onerous by its comment to the jury to the effect that petitioner should have produced his temporary collection book records (*which his witness Poska had testified had been turned over to him only after verification and recordation in the permanent books of account—R. 399*) in order to demonstrate to a mathematical certainty that his witnesses had told the truth (R. 417).

In other words under this Court's pronouncement in *Holland* v. *United States, supra,* 75 S. Ct. at pp. 136, 137, the Government, which has the burden of proof, may sustain its burden by merely showing a "likely source" but under the charge of the trial court, the defendant's proofs negativing the existence of a likely source, must at the risk of an adverse inference be established to a mathematical certainty.

The Government did not establish a "likely source" of the alleged net worth increase attributable to currently taxable income. In this respect the decision of the Court of Appeals affirming the judgment of the trial court is in conflict with the decision of this Court in *Holland* v. *United States, supra.*

2. The Government Did Not Establish, With Reasonable Certainty, an Opening Net Worth

The decision of the Court of Appeals is in conflict with the decision of this Court in *Holland* v. *United States, supra,* 75 S. Ct. at p. 134, in that, in the present case, the Government did not establish with reasonable certainty, an opening net worth.

There is no question but that the Government Agents erred in not including any part of the proceeds of the "$114,000 item" in their opening net worth computation. Under any theory, even under the "turnover" theory adopted by the Government, at least the original down payment part of this amount should have been included. The exact amount which should have been included as an asset in the opening net worth computation is shown in the photostat of the 73 page account of this transaction on file with this Court. The account of this transaction ties in so accurately with the bank records and other evidence in this case, that its authenticity is beyond question. For example petitioner's loan record at the Idaho First National Bank, admitted as Government Exhibit No. 16, and reproduced at page 11 post, shows the following bank payments, all of which were charged against petitioner as *taxable income* namely,

Feb. 5, 1945	$1,400
Mar. 1, 1945	1,500
Mar. 19, 1945	1,000
Apr. 10, 1945	1,000
May 14, 1945	2,500
Total	$7,400

The "cash account" portion of the "$114,000 item" account on file with this Court shows the following:

1945		
2/5	Banked	$1,400
3/1	Banked	1,500
3/19	Banked	1,000
4/10	Banked	1,000
5/14	Banked—Note in full	2,500
	Total	$7,400

The two independent sets of records, one kept by the bank and the other kept by petitioner, tie in together perfectly.

The same "cash account" also shows $2,000 to J. Sonduck on June 9, 1945, and $1,000 on July 23, 1945. These payments tie in with the Government's proofs of the loans to Sonduck (R. 169-170), based on the records of Sonduck & Schwenk Lumber Company.

These items could not and did not represent income. Their source is traceable directly to this capital asset or "cash" account which was not an income account.

The complete omission of these assets growing out of the "$114,000 item" was erroneous. This omitted source alone was more than sufficient to completely exonerate petitioner for 1945.

The real problem, however, is whether the state of the record is such as to justify the failure of the Government Agents to include this item or its proceeds as an asset in their opening net worth computation. If the agents were justified in their omission then it might be said that the burden of going forward with the evidence on this issue shifted to the defendant.

(a) The Government Agents Failed to Track Down the Lead as to the Existence of the $114,000 Item

This Court indicated in *Holland* v. *United States, supra,* 75 S. Ct. at p. 135 that the Government Agents using the net worth method should use reasonable diligence to track down leads as to the existence of substantial assets.

In the present case the Government Agent Rice said (R. 263):

> " * * * also another item at issue related to 1943. We could not account for something in excess of $100,000.00 which had been made for merchandise, as I recall the figure it was somewhere around $114,000.00 but I am not certain of that exact amount. Mr. McFee explained at that time that the money for the merchandise could be accounted for he believed through the Foresters Club at Lewiston and Coeur d'Alene."

On cross examination Rice testified that petitioner told him this item could probably be accounted for on the Foresters Club books, that it related to the purchase of whiskey, and that the $114,000 represented a total sum of a turnover (R. 288). Rice said they had evidence of from 5 to 7 loads coming from the east.

(1) The amount paid to petitioner by the Foresters Club at Lewiston for its liquor inventory was $18,461.21 in 1943, $2,546 in 1944, and $6,915.95 in 1945, a total of $27,923.14. The amount paid to petitioner by the Foresters Club at Coeur d'Alene for its liquor inventory was $20,137 in 1943, $18,985 in 1944 and $4,127.50 in 1945, a total of $43,249.50, all in reimbursement of petitioner's original investment. The portions of the account marked "Foresters of America, Lewiston, Idaho" and "Foresters of America Coeur d'Alene" on file with this Court show these payments in detail.

These items totalling $71,172.64 had to be on the Foresters Club's books of account because they were items of cost to these clubs. Otherwise their net sales and net

taxable income would have been *overstated* by $71,172.64 over the three year period involved.

The revenue agents knew the items represented liquor inventory to the Foresters Clubs. All they had to do to verify the existence of this substantial asset was to examine the Foresters Clubs records of inventory purchases for these years all of which were under investigation. The agents had access to these accounts and records (R. 75).

If they had needed additional information or verification they could have interviewed Lucile Dolan, who was the manager of the Coeur d'Alene office of the North Idaho Sales Company during the entire period of this liquor transaction, and was still there when the Government Agents conducted their investigation (R. 360, 367). She was familiar with these purchases of inventory from petitioner (R. 364, 367-368). She checked out the inventory and verified the payments to petitioner (R. 368).

Or they could have interviewed the managers of these clubs, Whitaker (R. 300) and Delyea (R. 325).

R. E. McDonnell was the man who actually handled the entire liquor transaction in 1943 (R. 307). The Government Agents knew this, for McDonnell was called as a Government witness to establish the payment of the O.P.A. fines growing out of the same transaction (R. 113).

Here was an item sufficient to completely exonerate petitioner for the year 1945 and probably for 1946 also in view of other substantial demonstrable errors. Petitioner told them exactly where they could have traced at least $71,172.64 thereof. *Yet there is not one word of evidence in the Government's proofs showing that they attempted to run down this important lead except that agent Rice said they had evidence of from 5 to 7 loads or shipments coming from the east, that the money was all paid in cash and that petitioner told them it was a turnover* (R. 288).

The information about 5 to 7 loads is at most a neutral element. There necessarily would have been several loads if the entire amount of the "$114,000 item" had been paid

in a lump sum. The original $109,940 investment actually required 5 loads as shown by the account of the transaction on file with this Court.

Moreover, even under the "turnover" theory the original payment constituted an asset completely ignored by the Government Agents.

In *Holland* v. *United States, supra,* 75 S. Ct. at p. 135, this Court said:

> "* * * When the Government fails to show an investigation into the validity of such leads, the trial judge may consider them as true and the Government's case insufficient to go to the jury. This should aid in forestalling unjust prosecutions, and have the practical advantage of eliminating the dilemma, especially serious in this type of case, of the accused's being forced by the risk of an adverse verdict to come forward to substantiate leads which he had previously furnished the Government. It is a procedure entirely consistent with the position long espoused by the Government, that its duty is not to convict but to see that justice is done."

It is inconceivable that the Government Agents did not take these simple investigative steps. But if they did, they suppressed this information favorable to the petitioner in order to bring about a conviction.

This case falls squarely within the letter and spirit of the above quoted precept of this Court. Petitioner submits that this is an additional reason for granting the writ, for the decision of the Court of Appeals is not in accordance therewith.

(b) There is no Substantial Independent Evidence Corroborating Appellant's Alleged Statement that the $114,000 Item Represented a Turnover

In speaking of the necessity of corroboration of statements of the accused by independent evidence, this Court said, in *Smith* v. *United States,* 348 U. S. 147, 75 S. Ct. 194, 199, — L. Ed. —:

> "It is the practical relation of the statement to the Government's case which is crucial, not its theoretical relation to the definition of the offense."

In the present case the entire $114,000 represented an asset unless it was a "turnover", which is surely a practical relationship.

In *Smith* v. *United States, supra,* 75 S. Ct. at page 199, this Court also said:

> "All elements of the offense must be established by independent evidence or corroborated admissions."

The establishment of the opening net worth was a vital element in the proof of the offense.

In *Opper* v. *United States,* 348 U. S. —, 75 S. Ct. 158, 164, — L. Ed. —, this Court, speaking of corroboration, said:

> "It is necessary, therefore, to require the Government to introduce substantial independent evidence which would tend to establish the trustworthiness of the statement."

In the present case the only evidence supporting the "turnover" theory produced by the Government was Agent Rice's statement (1) that they had evidence of from 5 to 7 shipments or loads and (2) that petitioner told them the $114,000 item represented a "turnover." As pointed out above, the "5 to 7 loads" is a neutral element. It is entirely consistent with a lump sum payment, for such a large payment of necessity would require several shipments. This crucial element of proof therefore rested primarily on petitioner's alleged "turnover" statement. It is extremely doubtful if petitioner ever made such a statement, for it was not true. The turnover came about only after $89,533 worth of whiskey paid for in the original payments, had been shipped and received.

The only other evidence on the point was that of McDonnell, a witness produced by petitioner. He testified

that the $114,000 was a lump sum amount of which petitioner advanced $102,700 to him (R. 307, 324), and that his first purchase from this fund was a $70,000 payment in St. Paul (R. 310) in July 1943.

There was no independent corroboration of the alleged "turnover" statement of the petitioner. Petitioner submits that this is an additional reason for granting the writ, for the decision of the Court of Appeals ignoring this important requirement, is in conflict with the above quoted precepts of this Court announced in *Opper* v. *United States, supra,* and *Smith* v. *United States, supra.*

(c) The Government's Investigation of Petitioner's Financial History Prior to 1942 Was Wholly Inadequate

Petitioner contends that $75,000 of the amount comprising his cash fund on hand in 1943 can be traced to his substantial business activities extending back for a score of years prior to 1935. This period prior to 1935 not investigated by the Government Agents at all, because, they said, "That was hearsay." (R. 281)

The only evidence of petitioner's financial history from 1936 through 1941 was the amount of his annually reported net taxable income. No tax returns or books of account were produced for this period; there was no evidence of gross income, or of non-taxable capital gains, or of depreciation (which must have been substantial in view of the nature of his business and which represented a non-taxable return of cash). There was no investigation of his assets on hand during this period. There was no evidence of any financial embarrassment or financial shortage during this period. On the contrary, it was a period of prosperity. From 1936 through 1944 petitioner's reported net taxable income totaled $342,178.98 (R. 274).

The Government Agents merely assumed that his reported net taxable income represented his net worth for this six-year period, a violent assumption obviously erroneous. For example in the year 1945 petitioner with a net

taxable income of $25,163 realized a total of $31,007 of *non-taxable* cash or amounts receivable, not reflected in net taxable income, resulting from the non-taxable portion of capital gains, and the non-taxable return of capital—non-taxed because it represented a return of cost or other basis. All such practical and realistic considerations as depreciation, capital gains, and returns of capital common to petitioner's business, were ignored by the Government Agents for the entire period prior to 1942, in setting up their opening net-worth computation.

Thus we have a situation where petitioner's sustantial financial history prior to 1935 was completely ignored, the investigation of his financial history between 1936 and 1942 was wholly inadequate and was demonstrably erroneous, and for the period 1942-1944 an item of $114,000 was arbitrarily discarded in toto. The government's opening net worth computation was clearly erroneous, and its accuracy was not established with reasonable certainty, as required by this Court in *Holland* v. *United States, supra.*

3. The Trial Court Erred in Its Comment and in Its Instructions or Charges to the Jury

(1) The trial court made the following comment to the jury (R. 417):

> "I don't want to comment on the evidence but there is one outstanding matter that you are left in the dark about, I don't intend to make any inference about it, as the evidence here is solely for you. But where are the tickets that should show the receipts and division of the money taken from the slot machines or the years 1945 and 1946. There was only one of these books of tickets introduced in evidence by the defense. None of the witnesses bookkeeper, manager or other witnesses for the defense produced these tickets and all said they had no knowledge of these tickets. The tickets were traced to the possession of defendant McFee. It seems to the Court that if the tickets balanced with the bank account that it would

> have been an easy matter for the defense to produce the tickets if they have not been destroyed. Why were they not produced to show the receipts of the slot machines for these years."

The comment was excepted to (R. 424). The court then told the jury that they, and not he, were the judges of the inference to be drawn from petitioner's failure to produce the temporary collection-book records referred to.

The court's comment was particularly unwarranted and prejudicial.

Prior to being turned over to petitioner the collection book records had been checked, verified as to accuracy, balanced against bank deposits, and entered in the permanent books of account (R. 399). Government witness, Masterson (R. 204) and petitioner's witnesses Bergland (R. 295), Sherman (R. 334), Fields (R. 347), Parsons (R. 355), Whitaker (R. 300), Dellyea (R. 325), Dolan (R. 360), and Poska (R. 399) had definitely established the method of operation of petitioner's business solely by employees, and the meticulous care taken in verifying all collections against bank deposits, and in recording such collections in the permanent books of account. (See Appendix p. 2 post showing a summary of this evidence). The court told the jury, in effect, that despite all of such testimony, the petitioner could have demonstrated the truth of such testimony to a mathematical certainty if he had produced the collection books; and that petitioner's failure to do so was an "outstanding" circumstance from which they were entitled to draw an adverse inference.

This evidence related solely to the issue as to the existence of a "likely source" of income. The Government, which has the burden of proof, may sustain its burden merely by showing a "likely source" of unreported taxable income. *Holland* v. *United States, supra,* 75 S. Ct. at p. 136. It is not required to show the actual source. Much less is it required, at the risk of an adverse inference if it does not do so, to demonstrate to a mathematical certainty that

its witnesses were telling the truth. *Holland* v. *United States, supra,* at p. 137. But under the trial court's comment to the jury, the accused in this case was required not only to establish the absence of a likely source, but he was required also to establish to a mathematical certainty that his witnesses, who had testified under oath, had told the truth.

Both trial and appellate courts should be alert to the reasonable inferences both for and against the accused. *Holland* v. *United States, supra,* 75 S. Ct. at p. 132. Both the trial court and the appellate court in this case have been alert to the inferences for the Government and against the accused; but the converse is not true.

The comment of the trial court was highly prejudicial. Its action and that of the appellate court in approving such action, is contrary to the precepts of this Court stated in *Holland* v. *United States, supra,* referred to above.

(2) The trial court instructed or charged the jury as follows (R. 419):

> "The presumption is that a person intends the natural consequences of his acts, and the natural presumption would be if a person consciously, knowingly or intentionally did not report all his taxable income for the years 1945 and 1946 and thereby the government was cheated or defrauded of taxes, that he intended to defeat the tax.
>
> "Bona fide mistakes should not be treated as false returns or as a willful attempt to evade the payment of income tax; however, the duty to file the return is personal and it cannot be delegated, and no man who is able to read and write and has the mentality to understand business transactions and who signs a tax return should be allowed to escape the responsibility of good faith and ordinary diligence as to the correctness of the return which he signs, whether prepared by himself or somebody else."

The foregoing charges clearly incorporate the theory of presumptive intent. In *Wardlaw* v. *United States* (5 Cir.),

203 F. (2d) 884, a similar charge, almost identical in wording with the first paragraph quoted above was held to warrant reversal.

There was no exception to this charge in the present case. But in the recent case of *Bernard Bloch* v. *United States,* — F. (2d) — (No. 14,266, decided by the Court of Appeals for the Ninth Circuit on April 11, 1955), the appellate court, of its own motion, and without exception thereto having been made, noticed the error and held that substantially the same instruction or charge was prejudicially erroneous, and reversed the conviction. This question was raised in the Court of Appeals in this case.

Petitioner submits that the prejudicial comment to the jury and the erroneous charge to the jury, referred to above, provide additional reason for the allowance of the writ.

4. Further Clarification of the Practical Application of the Principles Announced in Holland v. United States Is Needed

In *Holland* v. *United States, supra,* this Court announced certain precepts and admonitions concerning the use of the net worth method in criminal prosecutions. In that and the associated cases, the convictions were sustained because the proofs conformed thereto. This Court has not decided any case where a conviction resulted from a failure to observe and apply those standards. This is such a case. If the teachings of *Holland* v. *United States* may be disregarded arbitrarily or by misinterpretation by the lower courts, the danger of unjust convictions is not minimized, and the administration of justice in this comparatively broad field of application becomes a matter of personal interpretation rather than one of general conformance to the applicable principles announced by this Court. The decision of the Court of Appeals in this case evidences a need for further clarification.

This case is distinguishable from *Holland* v. *United States, supra; Friedberg* v. *United States,* 348 U. S. 142,

75 S. Ct. 138, — L. Ed. —; *Smith* v. *United States*, 348 U. S. 147, 75 S. Ct. 194, L. Ed. , and *United States* v. *Calderon*, 348 U. S. 160, 75 S. Ct. 186, — L. Ed. —, in the following specific particulars:

In the *Holland* case the books of account were shown to be erroneous (75 S. Ct. p. 136). In the present case there was not a single error of any kind shown on the books of account. The books were kept *by employees* and verified by an expert accountant (R. 62) who prepared the tax returns and testified that the returns correctly reflected the books of account (R. 69) and that the records were carefully checked by him and reconciled with the bank deposits (R. 65, 66, 68, 75, 80).

In the *Holland* case there was "evidence of a consistent pattern of under reporting large amounts of income and of failure *on the petitioner's part* to include all of their income in their books and records (idem. p. 137). In the present case there is no such evidence. Petitioner even overpaid his 1944 income tax (R. 290). Petitioner did not have anything to do with the books of account. Everything was handled by employees who took meticulous care to record all transactions.

In the *Holland* case the Hollands claimed they had a hoard of over $100,000 in $100 bills. But the Government showed that subsequent to the claimed time of existence of the hoard the taxpayers endured a series of privations which negatived the existence of such a hoard. They lost their cafe business, accumulated $35,000 in debts which were never paid, lost their household furniture because of an unpaid balance of $92.20, suffered a default judgment for $506.66, were forced to separate for eight years because it was to their economic advantage, and that Mrs. Holland had to support herself and their son by working, that improvements in the hotel during the prosecution period were paid in installments (idem. p. 134).

In the present case there was some evidence of privation in 1935, but there was a remarkable degree of financial

success thereafter. Up to 1945 petitioner had reported over $342,000 in income. Petitioner contends that he had cash on hand of at least $102,700 in July 1943 (R. 307). There is no evidence that shows or even tends to show that he endured any privations after 1935 or that he had any unpaid debts or judgments against him or that he did anything that he reasonably would not have done if he had actually had that amount of cash.

The evidence in the present case does not contain any of the many elements which were relied upon in the *Holland* case as indicating a "likely source" of unreported income during the prosecution period.

In the *Friedberg* v. *United States, supra,* 75 S. Ct. 138, the issue of a "likely source" was not discussed. But the Government did show in that case that during a long period of years prior to 1941, during which time Friedberg claimed to have accumulated $60,000 in cash, he too experienced a continuous and repeated series of privations and financial reverses.

In the present case subsequent to his short period of cash shortage in 1935 petitioner enjoyed phenomenal success financially. He endured no privations subsequent to 1935 or subsequent to 1943 when he claimed the existence of his cash fund.

Smith v. *United States, supra,* 75 S. Ct. 194, involved primarily the question of corroboration of admissions. The accused himself had given the Government a signed net worth statement which admitted his understatement of taxable income. There was no net worth statement given by the petitioner in the present case.

United States v. *Calderon, supra,* 75 S. Ct. 186, the primary question was one of corroboration. Calderon had given the Government agents a net worth statement, which, in effect, admitted the existence of currently unreported taxable income. This Court pointed out that Calderon's own testimony, claiming a larger amount of cash on hand at the beginning of prosecution period still

was not sufficient to account for the unreported income for even the first prosecution year (idem. at p. 190).

In the *Calderon* case the records were shown to be incomplete, the coin machine receipt books were not numbered, some receipt books appeared to be lost or misplaced prior to recordation, and apparently Calderon had access to the proceeds of the machines prior to their recordation (idem. at p. 189).

In the present case every receipt book was numbered, all collections were made by employees, all cash collected was checked and balanced against the receipt books by employees, and deposited in bank and recorded on the books of account by employees. The books of account were accurately and correctly kept and audited and none of the receipt books were lost or destroyed prior to recordation on the books of account. The evidence also affirmatively shows that no amounts were turned over to petitioner prior to their recordation in the permanent books of account.

In the *Calderon* case this Court, also pointed out that proof that the taxpayer was impoverished in 1935 was too remote to substantiate the opening net worth statement absent adequate proof of taxpayer's financial circumstances in the intervening years (idem. p. 188).

In the present case the proof of impoverishment also related back to 1935. As pointed out above, the Government's proofs concerning petitioner's finances during the intervening years was deficient in several important respects, and the evidence produced showed a highly successful intervening financial history.

The important elements relied upon to sustain the convictions in the *Holland, Friedberg, Smith* and *Calderon* cases, *supra*, are absent in the present case. This case presents an opportunity for clarification of its prior decisions which would be helpful in the administration of justice.

CONCLUSION

For the foregoing reasons petitioner respectfully submits that this petition for writ of certiorari should be granted.

ELDEN MCFARLAND,
Counsel for Petitioner.

APPENDIX

APPENDIX

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UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

No. 13,482
Apr. 29, 1955

AUSTIN F. MCFEE, *Appellant*,

vs.

UNITED STATES OF AMERICA, *Appellee*.

Appeal from the United States District Court for the District of Idaho, Northern Division.

Before MATHEWS, HEALY and ORR, Circuit Judges.

PER CURIAM.

As required by the Supreme Court's order of January 10, 1955, 348 U.S. 905, we have considered this case in the light of Holland v. United States, 348 U.S. 121; Friedberg v. United States, 348 U.S. 142; Smith v. United States, 348 U.S. 147; and United States v. Calderon, 348 U.S. 160, and have concluded that our decision of August 24, 1953, 206 F. 2d 872, was correct. The District Court judgment is, therefore, again affirmed.

(Endorsed:) Per Curiam Opinion. Filed Apr. 29, 1955.

Paul P. O'Brien, Clerk.

Summary of Evidence as to a "Likely Source"

Government Agent Olsen testified that the source of the "unexplained expenditures" was unknown (R. 242, 244). He admitted that they could have come from prior cash on hand (R. 254) or from prior earnings except that the agents had not located any such source (R. 250, 253). They assumed, because they did not know the source that it was taxable income. Agent Olsen testified (R. 250):

"Q. When you testified that the expenditures in 1945 and 1946 were in excess of the income—of the reported income, you implied that those expenditures were paid out of taxable income?

"A. That is correct."

Government witness, *Masterson* was the appellant's coin machine collector for the Wallace district (R. 210) which included Shoshone County in Idaho and Avery in Montana (R. 204). The collectors used collection books showing each location, the total amount collected, and the amount turned over to the proprietor of the location—which was 50 per cent (R. 205). The pages in the books were in triplicate. Each book was numbered and each page was numbered, and each set of triplicate pages bore the same page number (R. 209). The proprietor of the location signed the original page verifying the total "take" and his "split". The top copy was kept by the collector together with the second copy—which was a carbon copy. The third copy—also a carbon copy was given to the location owner (R. 205-208). The collector deposited the collections in bank with the book number noted on the deposit slip (R. 210). The deposit slip would have to balance with the collections shown on the book (R. 210). The books and the duplicate bank deposit slips were turned over to the bookkeeper in the company office (R. 206). The bookkeeper checked the books against the bank deposit slips and reconciled them with the books of account and *after they had been completely checked* turned them over to appellant (R. 398-399). There was no showing that appellant had access to or ever collected or received one penny of coin machine collections prior to their deposit in bank and recordation on the books of account. It was all done by employees.

The remaining witnesses on this point were called by the appellant.

Edward Bergland was the coin machine collector at Lewiston, Montana (R. 195). His testimony was similar

to that of Masterson. He had the keys for all machines (R. 296). The location owner was always present when the collections were made and verified the correctness by his signature (R. 296). The collections were rechecked against the collection books, balanced with the cash and turned over to the company bookkeeper in Lewiston, who made the deposit in bank (R. 297). *No money was ever turned over to appellant* (R. 298). *Appellant did not have a key to these machines* (R. 299), *and there was no master key.*

Leonard Sherman's testimony was similar. He had been the manager of the Coeur d'Alene office of the North Idaho Sales Company for the past ten years (R. 334) and he made the coin machine collections for the Coeur d'Alene area (R. 334). The collection book, verified by the location owner, was brought back to the branch office at Coeur d'Alene, turned over to the office girl, checked and verified as to accuracy by both of them and banked by the office girl (R. 335-336). The coin machines included phonographs, pinball machines and slot machines (R. 346, 352).

Richard Fields was a route supervisor at Wallace, who supervised the purchase and records for the phonographs, suppoles and other equipment. He also made coin machine collections (R. 347). His testimony was similar to that of the other collectors. All of his collections were balanced against the collection books and he deposited the collections in bank to the credit of the North Idaho Sales Company (R. 348-349). He had the keys to the machines most of the time (R. 348). *Appellant never made any collections* (R. 348). *No collections were ever turned over to appellant* (R. 350). Appellant had no "personal" machines (R. 353).

Charles Parsons was a collector out of Lewiston, Idaho, throughout 1945 and 1946 (R. 355). His testimony was similar to that of the other collectors. All collections were turned over to the company office girl, counted, checked against the collection books, and deposited in bank by her